



SBA 7(a) Lender Training Basics

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SBA Lender Resources

- **SBA Electronic Lending Web Site**
 - www.sba.gov/banking/
 - Standard Operating Procedure (SOP) 50 10 (4)= Processing SOP
 - Policy and Procedural Notices

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SBA Lender Resources

- **Michigan District Office**
 - (313) 226-6075, Fax (313) 226-4769
 - Bank Notes - <http://web.sba.gov/list/>
 - Lender's Page - http://www.sba.gov/mi/mi_lenderspage.html
 - 7(a) Application
 - Past Issues of Bank Notes
 - Lender's Training
 - Email – michigan@sba.gov

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What will be Covered

- Why Lenders use SBA Guarantees
- What is the SBA Program
- How SBA guarantees work
- SBA Information Sources and Contacts

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Why Participate in the SBA Guaranty Loan Program?

- **Reduces Lender Risk**
- **Enhance Lender Liquidity & Profitability**
- **Increase Lender Regulatory Loan Limits**
- **Expand Lender Services to Small Business**

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SBA Reduces Lender Risk

- **Loan guarantees of 50% to 85%**

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SBA Loan Enhance Lender Liquidity & Profitability

- The Guaranteed portion of an SBA 7(a) Loan Can Be Readily Sold in the Secondary Market
- Lender retains servicing fee on loan

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SBA Loans Increase Lender Regulatory Loan Limits

- The SBA Guaranteed Portion does not count against a lender's regulatory loan limit

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Expand Lender Services to Small Business

- Borrowers can receive Longer Loan Terms
- Start-ups can be financed
- Collateral shortfall eliminated

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What is the SBA 7(a) Guaranty Loan Program?

Topics to be covered:

- Guaranty Percentages
- Guaranty Fees
- Lender Fee
- Loan Terms
- Interest Rates
- 7(a) Loan Programs

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7(a) Guaranty Percentages

- \$150,000 or less = 85%
- Greater than \$150,000 = 75%
- Total Guaranteed Amounts not to exceed \$1,500,000 to any one borrower + its affiliates
- Loan Amount not to exceed \$2,000,000

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Calculation of Guaranty Fee

- SBA guaranty fee calculated as a % of the guaranteed portion
- Total loan amount is \$150,000 or less
 - 2% of the guaranteed portion is charged
 - 25% of this fee may be retained by the lender
- Total loan amount is \$150,001 - \$700,000
 - 3% of the guaranteed portion is charged
- Total loan amount is over \$700,000
 - 3.5% of the guaranteed portion is charged
- If the guaranteed portion exceeds \$1,000,000, an additional guaranty fee of .25% is charged for portion over \$1,000,000

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Lender Fee

- On-going servicing fee for all SBA 7(a) loans
 - Cannot be passed on to borrower!
- .545 percent annual fee on guaranteed portion of 7(a) loans (for FY 2006)
 - Paid monthly
 - Fee Percent may be changed annually
- For sold loans: Colson deducts lender fee from interest remitted to lender
 - So separate fee not necessary

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Maximum SBA Loan Terms

- Based on “ability to repay” and “life of assets”
 - Use of Proceeds (not collateral) is determinant
- Based on asset type:
 - Real Estate 25 years
 - Equipment, Fixtures 10 years
 - Working capital 7 years
- Mixed Loan Uses = Blended Term

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Weighted Average

Purpose	Amt	%	Mat	WGT
Real Estate	\$300.0	60	25	15
M&E	\$100.0	20	10	2
W/C	\$100.0	20	7	1.4
	\$500.0	100		18.4
18 year term!				

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SBA Interest Rate Policy

- Fixed and variable rates allowed
- Maximum rates
 - Tied to low prime rate published in Wall Street Journal or “optional peg” rate
 - Based on loan term
- < 7 years: Prime+2.25%
- 7 years or more: Prime+2.75%
- Loans \$50,000 or less can have higher rates
 - Loans up to \$25,000: 2 pts over max
 - Loans more than \$25,000 to \$50,000: 1 pt over max

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7(a) Loan Programs

- Regular
- Caplines
- Export Working Capital - 90% Guaranty
- International Trade
- SBAExpress - 50% Guaranty
 - \$350,000 Maximum (for all express loans)
 - Higher interest rates allowed
 - Prime + 6.5 for loans up to \$50K, Prime + 4.5 for loans over \$50,000
 - ExportExpress – 75% Guaranty for exporters
 - \$250,000 Maximum loan

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How SBA Guarantees Work

Eligibility Requirements

– Should be reviewed first!

- Credit Elsewhere
- Size Standards
 - Affiliates
- Ineligible Businesses
- Real Estate Requirements

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Credit Elsewhere Rule

- Funds cannot be available elsewhere under reasonable terms and conditions
- Sources that must be considered:
 - the lending institution
 - the internal resources of the applicant
 - the external resources of the applicant
 - the personal resources of the principals of the applicant

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The Lending Institution:

- Loan is not available on reasonable terms without an SBA guarantee
 - To justify reasonability, consider:
Loan amounts, interest rates, maturities, payment schedules and loan conditions
- Examples of unreasonableness:
 - Fixed assets financed with LOC
 - Demand notes
 - Balloon notes
 - Over abundance of collateral
- Can the business meet the existing and proposed debt service requirements?

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The Lending Institution: (cont'd)

- Lenders must certify and substantiate need for SBA guaranty
 - Form 4-I, Lenders Application for Guaranty
 - Listing of factors that demonstrate the need for an SBA Guaranty

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Internal Resources of the Applicant:

- Disposal of assets owned by the applicant
 - not needed by the business to conduct its operation
- Internal resources available after disbursement of the SBA loan must be considered

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External Resources of the Applicant:

Affiliate's assets not needed by the affiliate
for its operation

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Personal Resources of the Principals:

- Must determine if liquid assets of the applicant's principals are available
- Determine what amount of liquid assets are considered reasonable for the principals to retain by following the personal resource formula

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Personal Resources Rule

- Applies to 20% or more owners
 - Marital community of interest
 - Reducing ownership interest (6 months prior to application)
- “Liquid assets” of the principal + spouse + dependent children are considered
 - Equal Credit Opportunity Act consideration: Special Purpose Credit Program
- Documentation of calculation and procedure must be in lender’s file

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Calculation of Exemption

- SBA bases rule on “total financing package”, not loan amount
 - $TFP = \text{SBA loan} + \text{other loans} + \text{equity}$
- One exemption provided to each owner household
- Tiered calculation

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Personal Resource Exemption:

<u>TFP</u>	<u>Exemption</u>
whichever is greater:	
\$250,000 or less	2x or \$100,000
\$250,001 - \$500,000	1.5x or \$500,000
Over \$500,000	1x or \$750,000

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Liquid Assets?

- Liquid Assets =
 - Cash and cash equivalent (marketable securities)
 - Cash Value of life insurance policies
- Pledged liquid assets
- “Not” Liquid Assets:
 - IRAs, 401K, Keogh
 - Non-marketable stocks

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Personal Resources Rule

- Liquid assets “pledged” to other debt (exempt)
 - If obtained prior to 6 months from date of application
 - dollar value of assets that can be exempted must be no greater than the lesser of the amount of the debt or the amount of the face value of the liquid assets securing the debt
 - pledged cash value of life insurance (exempt)
 - can be reduced by the lesser of the CSV pledged to secure a debt or the amount of the debt

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Size of Business

- Based on the North American Industry Classification System (NAICS)
- SBA Size Standards
 - https://eweb1.sba.gov/naics/dsp_naicssearch2.cfm
 - 13 CFR, Part 121

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General Size Standards

- Retail/Service
 - Less than \$6.0 million in gross sales averaged over the last 3 fiscal years
- Wholesale
 - No more than 100 employees averaged over the last 12 months
- Manufacturing
 - No more than 500 employees averaged over the last 12 months
- Construction
 - Less than \$12.0 million in gross sales averaged over the last 3 fiscal years

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Size Standard Methodology

Calculation of Receipts

- Based on “gross income”
- For completed fiscal year (taxable year)
- Receipts considered for 3 completed fiscal years
- Average income

Calculation of Number of Employees

- Consider ALL employees
 - Full-time, part-time, temporary
- Average number of employees over the last completed 12 calendar months

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What About Affiliates?

- The applicant + affiliates must be combined to determine eligibility
- Two pronged test:
 - Entire group, as a unit, must meet standard for the group’s primary industry
 - The applicant, itself, must meet its size standard

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What Is an Affiliate?

When:

- One party controls
OR
- A 3rd party controls both
OR
- An identity of interest exists

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First Affiliation Test:

- Determine Primary Industry – NAICS
 - Based on last fiscal year
- Combine employees or receipts for applicant and affiliates
 - Calculate average
 - Employees = last 12 months
 - Revenues = last 3 fiscal years
- Compare to SBA size standard

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How Do You Determine “Primary Industry”?

- Revenues
- Employees
- Costs of Doing Business\
- Determination based on most recently completed Fiscal Year

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Ineligible Businesses

- Financial businesses
- Life Insurance companies
- Pyramid Sale distribution plans
- Government-owned entities
- Cooperatives
- Loan Packagers
- Speculative businesses

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More Ineligible Businesses...

- Gambling Activities
- Promoting Religion
- Providing Sexual Material
- Prior Loss to the Government
- Passive Owners of Property
- Principal(s) are on Probation or Parole
 - Principals that have ever been arrested, charged, or convicted must be cleared through the District Office before proceeding with an SBA loan

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Real Estate Occupancy Rule

Existing Property

- 51% occupancy
- No additional occupancy requirement
- Loan proceeds cannot be used to remodel rental residential space

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Space Occupancy Rule

For New Construction Loans

- 20% of space may be leased out “permanently”
- 60% of space must be occupied by the applicant “permanently”
- 20% of space may be leased out “temporarily”
 - applicant must occupy some of the space within 3 years
 - applicant must occupy all of the space within 10 years

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Eligible Passive Company

- An Eligible Passive Company (EPC) is generally formed to hold the fixed assets of an Operating Company (OC)
- What makes this different from an “ineligible” passive company?
 - All parties financially obligated
 - Not considered investment because of lease arrangement
 - Benefit to a small business concern

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EPC Eligibility Components

EPC Elements

- Must be “SBA eligible”
 - Size and type
 - For-profit
 - Loan proceeds must be eligible
- Any legal structure

OC Elements

- Must be “SBA eligible”
 - Size and Type
- Must lease assets directly from EPC

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Other EPC/OC Requirements

- No identity requirement b/w EPC and OC
- Written lease is required; terms equal
- Assignment of rents required
- Rent payment cannot exceed loan payment + property upkeep
- ALL parties financially obligated
 - Principals of both EPC and OC must guarantee
 - OC must guarantee or co-borrow

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Refinancing Existing Debt

- Two-tiered Test:
 - Credit must not be available elsewhere
 - (reasonableness test)
 - Refinancing must provide small business a substantial benefit

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Reasonable Terms?

- Is the existing cash flow adequate to meet the existing obligations
- Reasonable at inception may or may not still be reasonable for current needs of the business
- Be careful of credit risk

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Substantial Benefit?

- Long-term Debt
 - 20% improvement to payment
- Short-term Debt
 - Revolving lines of credit
 - Business credit cards
 - Interest only loans
 - Balloon notes

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20% Calculation

- Note payment must be at least 20% less than existing payment
- Improved debt service must be needed for some viable business purpose
 - Justification must be in file

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Example of 20% Comparison

New money \$100,000
Refinance \$100,000
Total SBA loan \$200,000
SBA monthly payment amount = \$5,000
Existing N/P payment amount = \$4,000
\$100,000 is 50% of total; $50\% \times \$5,000 = \$2,500$
\$4,000 vs. \$2,500 = 38% improvement

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What about Multiple Notes?

- Each individual debt refinanced DOES NOT have to be improved by 20%, but none may have a higher debt service after the refinancing

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Refinancing SAME LENDER debt

- Must be current for the last 36 months:
 - Not more than 29 days pass due at any time during that period
- written certification of currency
- transcript of account
- Regular processing only

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SBA 7(a) Application

- 7(a) Application package is available on Michigan District Web Page.
- Steps to ensure good package:
 - Review application checklist to ensure all required items are included
 - Complete Form 912 (Statement of Personal History)
 - All required signatures
 - No internal inconsistencies between write-up, financial statements and spreadsheets.

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Lender Training Evaluation

- Stay on line and complete Ready Talk Evaluation or
- Send comments/questions/evaluation to Michigan District Office
 - Email – michigan@sba.gov
 - Fax – 313-226-4769

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